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November 30, 2006



Via HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, D.C. 20423

ENTERED
Office of Proceedings

NOV 30 2006

Part of
Public Record

Re: **Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1)**

Dear Secretary Williams:

Enclosed are the original and twenty copies of the Reply Comments of the Association of American Railroads ("AAR") submitted in response to the Board's decision served July 28, 2006, and its subsequent scheduling order served September 15, 2006, in the above-captioned proceeding. Also enclosed are three CDs each containing an electronic version of AAR's Reply Comments in Word format. Please date stamp the extra copy of this letter and return it with our messenger.

Sincerely,

Samuel M. Sipe, Jr.
Counsel for Association of American
Railroads

Enclosures

cc: Parties of Record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REPLY COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

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BNSF Railway Company

Theodore K. Kalick
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REPLY COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

I. Introduction

Pursuant to the Board's order issued on September 15, 2006, the Association of American Railroads ("AAR") respectfully submits its reply comments in the captioned proceeding.

In its opening comments, AAR commended the Board for setting out a framework of simplified rate standards and expedited procedures that could facilitate the resolution of rate cases where a full stand-alone cost ("SAC") presentation is not warranted. Although AAR's members do not welcome the prospect of additional rate litigation or believe that significant regulatory intervention is needed to ensure reasonable rates, they acknowledge that the governing statute protects shippers from abuses of market power and believe that shippers should have access to the Board to rectify such abuses where they are shown to exist. The proposals that the Board has advanced in this proceeding constitute a serious and thoughtful effort to enhance access.

AAR has carefully reviewed the comments of the various parties submitting opening comments in this proceeding, including the comments of numerous shipper organizations. For

the most part, the shipper comments are critical of the Board's proposals. The umbrella shipper filing, which we will refer to as the Joint Shipper Comments, asserts that "adoption of the primary features of the Board's proposal would make a currently poor situation much worse, and would effectively foreclose all possible small rate case challenges in the future."¹ The Joint Shippers' criticism is neither fair nor constructive. The Board plainly faces a daunting task in attempting to formulate *simplified* maximum rate standards that balance the directives of Congress to protect shippers from paying unreasonable rates in the absence of effective competition and to assist railroads in attaining the revenues necessary to support viable rail networks that meet shipper needs. The shippers should acknowledge the challenge faced by the Board and seek to improve upon the Board's proposals – or suggest a superior alternative approach – rather than condemn the Board's proposals out of hand.

II. The Shippers Improperly Advocate a Retreat from Market Based Pricing

The shippers' condemnation of the Board's proposals appears to be an outgrowth of their desire to expand broadly the universe of rates that can be challenged under the crudest standards, and to obtain virtually automatic rate relief for those shippers that believe their rail rates are too

¹ Joint Shipper Comments at 4. The Joint Shipper Comments were submitted by the American Chemistry Council, American Forest and Paper Association, American Soybean Association, Colorado Wheat Administrative Committee, The Fertilizer Institute, Glass Producers Transportation council, Idaho Barley Commission, Idaho Wheat Commission, Institute of Scrap Recycling Industries, Montana Wheat and Barley Committee, National Association of Wheat Growers, National Barley Growers Association, National Corn Growers Association, National Council of Farmers Cooperatives, National Farmers Union, National Grain and Feed Association, National Sorghum Producers, The National Industrial Transportation League, National Oilseed Processors Association, National Petrochemical & Refiners Association, Nebraska Wheat Board, North American Millers Association, North Dakota Grain Dealers Association, North Dakota Public Service Commission, North Dakota Wheat Commission, Oklahoma wheat Commission, Paper and Forest Industry Transportation Committee, PPL EnergyPlus, LLC, South Dakota Wheat Commission, Texas Wheat Producers Board, USA Rice Federation, Washington Wheat Commission, Alliance for Rail Competition, and Consumers United for Rail Equity.

high. This objective is at odds with the governing statutory scheme, the public interest, and actual conditions in surface transportation markets.

The Staggers Act established that rail rates are to be determined by the operation of market forces and that regulation of rail rates should be the exception rather than the norm. The first three factors of the National Rail Transportation Policy speak explicitly to the ratemaking flexibility that Congress determined must be allowed to railroads. The Board is directed “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates.” 49 U.S.C. § 10101(1). Similarly, Congress expressed its intention “to minimize the need for Federal regulatory control over the rail transportation system,” and directed the Board “to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues.” 49 U.S.C. § 10101(2) & (3). Congress and the Board have recognized that a regulatory regime that deprives railroads of the opportunity to earn their cost of capital is not in the public interest. It would only lead over time to a deterioration in service and a contraction of the rail network.²

Because the goal of Congress was to provide the nation’s railroads with an opportunity to earn their cost of capital by allowing market forces to operate to the maximum extent possible, Congress provided for only limited regulatory authority over rail rates. Under the statute, the Board may assess the reasonableness of a rate only if it determines that the railroad has market dominance. 49 U.S.C. § 10701(d)(1).³ The clear intent of the statute is to protect shippers from

² Congress directed the Board to “make an adequate and continuing effort to assist [rail] carriers in attaining revenue levels” sufficient to “attract and retain capital in amounts adequate to provide a sound transportation system in the United States.” 49 U.S.C. § 10704(a)(2).

³ The Board is precluded from finding a rate unreasonable if it results in an R/VC of less than 180%. 49 U.S.C. § 10707(d)(1). Moreover, the statute specifically envisions that rates above that level may be reasonable and do not necessarily reflect an exercise of market power. 49 U.S.C. § 10707(d)(2).

abuse of market power, not to guarantee a particular rate level. As the ICC recognized long ago, Constrained Market Pricing (“CMP”) provides “an appropriate regulatory framework” that meets the “dual objectives of providing railroads the real prospect of attaining revenue adequacy while protecting captive . . . shippers from ‘monopolistic’ pricing practices.”⁴ In order to maintain the financial viability of our rail system and the integrity of its own regulatory regime, the Board should reject proposals that would undermine the application of fundamental CMP principles in rate reasonableness determinations.

The shipper proposals in this proceeding, which would shift the Board’s focus from guarding against market power abuse towards insulating shippers from competitive market forces, are precisely the sorts of proposals that the Board should not adopt. According to the shippers, the need for rate relief in smaller cases is acute. However, the Staggers Act and its reliance on market forces have served shippers well. According to a recent report by the U.S. Government Accountability Office, rail rates decreased by more than 20 percent between 1985 and 2004 in real terms, and the percentage of all traffic moving at rates over the 180 percent R/VC safe harbor has declined.⁵ The shippers do not – and could not – argue that there is pervasive market power abuse by the railroads. Rather, they assert simply that prices have become too high and they are therefore entitled to rate relief. They cite market conditions – namely constrained rail and truck capacity – as the cause of price increases. *See* Joint Shipper Comments at 7, 38. In other words, shippers contend that they are entitled to relief from higher prices that result naturally from the working of market forces, specifically the interplay of supply and demand.

⁴ *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520, 524 (1985)(“*Coal Rate Guidelines*”).

⁵ U.S. Government Accountability Office, *Freight Railroads* at 11-12, 31 (October 2006).

In providing shippers with simplified standards for rate challenges, the Board must exercise great care not to adopt rules that would interfere with the workings of efficient market forces. Shippers are correct that capacity constraints are resulting in higher prices, but the solution to capacity constraints is certainly not to reduce railroad revenues. Reducing railroad revenues would only exacerbate capacity constraints by both limiting funds available for capital expenditures and deterring railroads from investing in additional capacity. Railroads need to earn their cost of capital over the long term so that they can justify the investment required to meet the growing demand for surface transportation capacity.

Most of the shippers' criticisms of the Board's proposals are directed toward allowing as many rate challenges as possible to be brought under the simplest, *i.e.* the crudest and least accurate approach.⁶ Shippers do not propose specific new eligibility thresholds, but they argue that the Board should "drastically revise upwards its eligibility thresholds." Joint Shipper Comments at 5. Shippers argue that the Board should have no aggregation rule, so that a shipper could disaggregate large, high-value cases that would merit a full SAC analysis into smaller claims that would be decided under a less accurate approach. Joint Shipper Comments at 6, 19-22. Shippers also encourage what they perceive to be the Board's intention to revoke exemptions to permit rate challenges on traffic previously found to be competitive. They suggest that such revocations are necessary because "rail capacity has tightened and the availability of transportation by other modes has declined because of tighter capacity in those modes as well." Joint Shipper Comments at 38. In other words, exemptions should be revoked because tight

⁶ For example, shippers appear to believe that the Board's goal should be to make the preferred full SAC analysis the exception rather than the rule and complain that "under the unrealistic assumptions underlying the Board's eligibility standards, most shippers would fall under the large case, Full-SAC procedures." Joint Shipper Comments at 4.

supply has resulted in higher prices. They further advocate a watered down revocation standard which improperly equates market power with the more limited market dominance concept.

In advancing their arguments, the commenting shippers appear to have lost sight both of the Board's goal of improving access to the Board for shippers with low-value cases and of the simplification rationale that justifies standards that are less precise than SAC. Shippers complain that the Board's proposed simplified SAC procedures are too costly, and that they therefore do not provide meaningful relief and will not be used. If cost estimates by the Joint Shippers' experts are to be believed, even the simplified Three Benchmark approach will not be accessible for relatively low-value cases.⁷ However, rather than addressing the perceived problem of excessive litigation costs by proposing additional simplifications, the shippers suggest that the Board has already simplified too much, not too little. They argue that the Board must give up on trying to develop simplified SAC procedures for medium-sized cases because the procedures the Board proposes do not permit the full range of strategies afforded a complainant in a full SAC case. They also argue that additional complicating, and cost increasing, features must be added to the Three Benchmark proposal for it to become acceptable. For example, shippers seek to expand the complexity of determining a comparable group by permitting inquiry into whether "different commodities could have similar transportation, demand, and market characteristics." Joint Shipper Comments at 35-36, 38. Shippers also seek to introduce one-sided complexity into interpreting the results of the Three Benchmark analysis. If a rate is above a reasonable level as determined by the proposed Three Benchmark formula, railroads would be prohibited from introducing evidence that the rate is nevertheless reasonable. Joint Shipper Comments at 37 ("If

⁷ However, other commenters in this rulemaking proceeding suggest that small cases could be litigated for as little as \$50,000. *See* Comments and Recommendations of Snively, King, Majoros, O'Connor & Lee, Inc. at 8.

the Board is saying that if the challenged rate is above the calculated formula, it would permit no other evidence by the carrier to show that the rate is reasonable, these Interested Parties would agree"). If a rate is below the level that the formula specifies as reasonable, however, "shippers should be able to show that there are individualized factors that make the rate unreasonable." *Id.*

Although they are the intended beneficiaries of the Board's proposed rules, the shippers have not offered proposals that further the goals of this proceeding. Their comments do not advance the goal of simplification. They make no effort to propose procedures that would give shippers with low-value cases improved access to the Board. Instead, the shipper comments are devoted to expanding the ability of larger shippers to make use of simplified procedures and to expanding the number of rates that would be subject to less precise reasonableness standards. The Board should not allow its proposals to become the occasion for a new regime of rate regulation that ignores the statutory directives to allow market forces to determine rates whenever possible and to assist railroads in attaining adequate revenues.

III. The Board Should Not Increase its Proposed Eligibility Thresholds

In its opening comments, AAR stated that the Board should not establish eligibility thresholds for medium-sized and smaller cases any higher than those proposed in the 646 *NPRM*.⁸ Both the statute and sound policy require that simplified, less accurate maximum rate standards be used only where the value of the case does not justify the use of more precise standards. While various commenting parties suggest that the proposed eligibility standards are too low, none suggests a principled basis for setting standards at different, higher levels.

The U.S. Department of Agriculture ("USDA") offers two concrete proposals with respect to eligibility thresholds. First, USDA suggests that eligibility caps should be raised to

⁸ See *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1), slip op. at 33 (served July 26, 2006)("646 *NPRM*").

\$1.6 million for small cases and \$15 million for medium size cases.⁹ Second, USDA suggests that a shipper should be allowed to use the SSAC procedure regardless of the Maximum Value of Case (“MVC”) “if the shipper demonstrates that the rates appealed involve numerous origins, destinations, and commodities.”¹⁰ Both suggestions are flawed.

USDA’s threshold recommendations are based on the assumption that shippers will, on average, obtain a 10 percent rate reduction and that a shipper has, on average, a 50 percent chance of prevailing in a given case. Basing eligibility thresholds on the expected outcome of rate litigation before the Board, as opposed to the amount at stake, is not appropriate. Under the Board’s approach the statutory concept of “the value of the case” is defined objectively in terms of the maximum amount that the shipper could recover if it prevails. In contrast, the probability of success in a given case is inherently subjective and therefore indeterminate from a regulatory perspective. The Board should not be in the business of estimating the chances that parties will prevail in litigation before it. Establishing an “expectation” factor would place the Board in the untenable position of prejudging the likely outcome of future cases and then predicated its own rules on the accuracy of that prejudgment.

Moreover, there is an inherent bias in USDA’s mode of analysis. USDA is concerned that shippers with relatively low-value cases may be discouraged from bringing meritorious cases due to uncertainty surrounding litigation outcomes. Increasing eligibility thresholds, however, does not address the perceived problem. Allowing shippers with higher-value cases to invoke simplified standards does nothing to help shippers with lower-value cases. However, shippers with lower-value cases could benefit from increased predictability in the simplified rate case process so that a potential complainant with a meritorious case would be less concerned that

⁹ Comments of the U.S. Department of Agriculture, at 11.

¹⁰ *Id.* at 11-12.

it would waste money on unsuccessful litigation. By their very nature, litigation certainties can never be entirely eliminated, but they can be reduced over time by the consistent application of clear standards.

USDA's second proposal, which would allow certain shippers to invoke simplified SAC standards regardless of any eligibility threshold, makes little sense and is not consistent with the statute. The statute specifies that simplified procedures should be made available where the value of the case does not warrant the expense of full SAC litigation. The factors proposed by USDA – number of origins, destinations, and commodities – do not have a bearing on the overall value of the case. Such factors may add complexity, and therefore may affect the cost of litigation, but that is a question to be addressed in individual cases. If the value of a case is sufficient to justify a full SAC proceeding, the full SAC proceeding is required by the statute.

The Joint Shippers do not offer a clear proposal on what eligibility thresholds should be established by the Board, although they called on the Board to establish a “bright-line” test in their prior comments leading to the current proposals. Their experts simply conclude that the thresholds established by the Board are “far too low.”¹¹ The Joint Shippers suggest that the Board should use annual freight bills between a single origin and destination as the measure of eligibility instead of MVC, but they do not discuss their suggestion – or attempt to tie it to the Board's specific proposals here – other than to attach to their comments a pleading filed in 2004 that they have not bothered to update.¹²

The defects with the Joint Shipper's 2004 proposal are obvious. First, the Board has recently announced new rules in Ex Parte No. 657 (Sub-No. 1) that it expects will reduce the cost

¹¹ Opening Verified Statement of Gerald W. Fauth III, at 5 (attached as Appendix B to Joint Shipper Comments); *see also* Verified Statement of Thomas D. Crowley, at 6 (“MVC Levels Are Unrealistically Low”)(attached as Appendix A to Joint Shipper Comments).

¹² Joint Shipper Comments, Appendix C, at 7-10.

of future SAC cases.¹³ The Joint Shippers have made no effort to account for the reduction in the cost of litigating a full SAC case that could result from the simplifications adopted by the Board for full SAC cases. Second, the litigation cost calculations sponsored in the Joint Shippers' 2004 pleading are based on a "litigation risk multiplier" of three. As discussed in connection with the Department of Agriculture's proposal – which used a fifty percent chance of success – it is inappropriate to base determinations of eligibility on subjective assessments of likelihood of success. The fact that the Department of Agriculture assume a fifty percent likelihood of success whereas the Joint Shippers assumed a thirty-three percent likelihood of success underscores the arbitrariness of such an approach. There is no reason for the Board to encourage shippers to bring rate cases by artificially inflating eligibility thresholds based on assumptions regarding the likelihood of success in rate litigation. The legitimate purpose for eligibility standards is to identify those limited circumstances where the "value of the case" does not warrant a full SAC presentation, not to expand the number of cases that can be brought overall to account for the possibility that shippers will not prevail in some cases or will recover less than they are seeking.

The Joint Shippers also complain that the Board's MVC approach does not establish reasonable eligibility thresholds because it is calculated based on the difference between the challenged rate and a rate set at 180 percent of variable cost. Shippers contend that actual recoveries are likely to be much less because maximum rates would likely be set in excess of 180 percent of variable costs. The solution to this perceived problem, however, is not, as the Joint Shippers propose, to expand eligibility thresholds so that large cases can be brought under simplified and less accurate procedures. The solution is for a shipper in an individual case to

¹³ See *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1)(served Oct. 30, 2006).

justify a higher eligibility threshold by stipulating that it does not expect or seek to obtain a rate prescribed at 180 percent of variable costs. If a shipper were to stipulate, for example, that it sought to recover a rate no lower than 225 percent of variable costs, then it would be appropriate for the Board to calculate the MVC based on the difference between the challenged rate and a rate at the level of 225 percent of variable costs. The Board has already proposed a similar solution for dealing with the volume of traffic involved in simplified rate cases by providing that rate prescriptions “would be capped at the shipper’s representation of the annual tonnage at issue.” *646 NPRM*, slip op. at 34.

Allowing the shipper to specify the maximum value of the case would only work if the Board continued to adhere to its aggregation rules. Otherwise, shippers would be free to bring as many cases as they chose under less accurate simplified procedures and CMP would become nothing more than a historical curiosity. The Board wisely stated in the *646 NPRM*, slip op. at 34, that “[d]isaggregating claims that could and should be brought in a single complaint to manipulate the MVC calculation would not be permitted.” The shippers argue that there should be no aggregation rule, Joint Shipper Comments at 6, but that would invite wasteful, piecemeal litigation and prevent the Board from addressing shipper attempts to manipulate the regulatory framework. The Board must be vigilant to prevent abuses of any simplified procedures.

IV. The Board Should Not Withdraw Its Simplified SAC Proposal

A. Simplified SAC is a Reasonable Approach to Simplification

The Joint Shippers contend that the Board should simply scrap the simplified SAC methodology and rely exclusively on a modified version of the Three Benchmark approach. The shippers have given no good reason for the Board to depart from its simplified SAC proposal. In the *646 NPRM*, slip op. at 9, the Board reiterated that CMP and the full SAC test remain “the most accurate procedure available for determining the reasonableness of rail rates where there is

an absence of effective competition.” It therefore makes sense, as a simplification measure, to adopt a version of the full SAC test that retains as much as possible of the accuracy of the more complicated approach while eliminating features of full SAC litigation that significantly increase litigation costs and make full SAC cases impractical for smaller disputes. Requiring the litigants in smaller rate cases to adhere to a framework that retains as much of CMP as possible is sensible regulatory policy. This is precisely what the Board attempted to do by proposing simplified SAC. The Board identified and eliminated some of the most time-consuming, resource-intensive inquiries of the full-SAC analysis to produce a much less costly procedure for resolving medium-size disputes, albeit one that is concededly somewhat less accurate than full SAC. There is no dispute that simplified SAC more closely approximates full SAC than the Three Benchmark approach.

The Joint Shippers complain that the Board has somehow biased simplified SAC by eliminating their ability to create a fictitious least-cost, most efficient stand-alone railroad. In particular, they complain that “the proposed Simplified-SAC procedures remove any SARR efficiencies by mandating the use of existing infrastructure along the route of movement, by including all traffic in the traffic group, and by using the incumbent railroad’s system average operating costs.”¹⁴ In reality, this is a complaint about simplification itself. Arguments about the SARR traffic group, network configuration and operating expenses in full SAC cases are protracted and highly complex; they account for much of the cost of bringing a full SAC case. It is entirely appropriate for the Board to eliminate such cost and complexity in the interest of creating a version of the SAC test that can be more readily implemented.

¹⁴ Joint Shipper Comments at 29.

Shippers also complain that simplified SAC procedures will always result in higher rates than would be the case for a full SAC proceeding. They offer no proof of this assertion. Higher rates than full SAC rates could conceivably be a byproduct of simplification in some cases. If cases are to cost less (which is a benefit to shippers), there will necessarily be less precision in the result. In fact, however, there is no reason to believe that simplification will always work in the direction of higher rates. The use of cross-over traffic in full SAC cases, for example, has routinely resulted in better outcomes for shippers than would be the case if shippers were required to build the entire network necessary to serve their selected traffic group. The same will likely be true in simplified SAC cases as well, where the complaining shipper will benefit from the inclusion of all traffic that touches the issue traffic route, much of which will be cross-over traffic. The shippers' assertion that simplified SAC will always result in higher rates is therefore nothing more than speculation.

B. The Board Should Use the Percent Reduction Method to Establish Maximum Reasonable Rates in Simplified SAC Cases

While AAR believes that the Board is correct in its efforts to develop a simplified SAC methodology, AAR also believes that it would be completely inappropriate for the Board to abandon the percent reduction method and to use instead the Maximum Markup Methodology ("MMM") that recently has been adopted in Ex Parte 657 to establish maximum reasonable rates.¹⁵ There is no rational basis for capping rates for the many types of traffic that would typically be found in a simplified SAC traffic group at an average R/VC ratio as MMM would

¹⁵ The Board stated in the 646 *NPRM*, slip op. at 13, that it intends to apply the same rate reduction approach to SSAC cases that it adopts in Ex Parte 657.

do.¹⁶ Imposing such a cap would be directly contrary to the Board's disavowal of any "intent to return to an era of rate equalization among different traffic" when it initially adopted simplified rate standards and procedures in 1996.¹⁷

V. Shippers Do Not Need Access to Unmasked Waybill Data

In their comments on the Board's Three Benchmark approach, the Joint Shippers contend that it is unfair for railroads to have access to their own unmasked waybill sample data while the shippers do not because railroads would thereby have an advantage in identifying traffic for inclusion in the comparison group. This argument ignores the Board's statement the "[t]he comparability of a movement should depend on the characteristics of the movement, not the level of the rate for that movement." 646 NPRM, slip op. at 33. In other words, neither complaining shippers nor defending railroads would have a need for access to unmasked waybill

¹⁶ The economic logic of MMM is closely related to that of the companion methodology that the Board proposed in Ex Parte No. 657, the Maximum Contribution Methodology ("MCM"). When the Board proposed MCM, it stated that MCM

is less-well suited to cases where the traffic group is diverse, such as where it is comprised of both short-haul and long-haul traffic, or both unit-train and manifest traffic. In those cases, the traffic in the group could have differing cost structures per ton-mile. Yet MCM would treat these movements similarly for purposes of their contribution towards the total SAC costs.

Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 13 (served Feb. 27, 2006). Allocation of SAC costs based on R/VC ratios is conceptually no different from allocation of SAC costs based on ton miles. Applied to a diverse traffic group in a simplified SAC case, MMM would produce the absurd result of rates on a wide range of traffic being capped at identical R/VC ratios.

¹⁷ *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1022 (1996). Adoption of MMM to establish maximum rates would be nothing less than an abandonment of the economic principles underlying CMP. When the ICC adopted CMP, it saw its task as development of "an economically efficient and equitable methodology for determining the reasonableness of rates." *Coal Rate Guidelines*, 1 I.C.C. 2d at 521.

revenue for purposes of selecting a proposed comparison group. Moreover, the Board's rules and precedent do not permit access to unmasked waybill data.¹⁸

The Joint Shippers imply that defendant railroads might seek to manipulate the selection of the comparison group based on their knowledge of the actual revenues on their own movements that have masked contract revenues in the waybill sample.¹⁹ But if contract movements are included in a proposed comparison group, the Board, which will choose between the two final offer comparison groups, will judge the comparability of contract movements to the common carrier movement at issue without regard to the level of the masked revenues.²⁰ Thus, an attempt to slip a non-comparable contract movement into a comparison group because it has favorable revenues would likely be self-defeating. Indeed, such a tactic would likely be eschewed as unacceptably risky in light of the Board's proposed baseball-style final offer approach to selecting the comparison group.

VI. The Board Should Allow Limited Departures from System Average URCS

In its opening comments, AAR noted that there are some circumstances where use of unadjusted URCS to calculate the jurisdictional threshold could lead to inaccurate results and urged the Board to permit sufficient flexibility to ensure accurate results in specific cases. Since that time, the Board has issued its decision in Ex Parte 657 (Sub-No. 1), in which the Board

¹⁸ 49 C.F.R. § 1244.9; *see also CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and Operating Leases/Agreements – Contrail, Inc. and Consolidated Rail Corporation*, STB Finance Docket No. 33388 (served Oct. 3, 1997).

¹⁹ Some degree of asymmetry in litigants' knowledge of the facts surrounding a dispute is inevitable. For example, shippers know more about the commercial context of their rail movements than do the carriers who haul the freight. One could argue that this would give them a leg up in selecting a comparison group.

²⁰ Indeed, one or both parties could decide to exclude contract movements from their proffered comparison groups on the theory that contract movements are not comparable to common carrier movements.

imposed a blanket prohibition on adjustments to URCS costs.²¹ AAR believes that the Board's decision in Ex Parte 657 regarding URCS was incorrect. In this proceeding, where the proposed simplified SAC and Three Benchmark approaches rely heavily on the calculation of R/VC ratios, the failure to allow adjustment to URCS on movements that have costs that will not be captured by or will be grossly understated by URCS would be a recipe for flawed results in some cases.

AAR requests that the Board modify its proposed treatment of URCS to allow inclusion of actual costs of movements that are not accurately captured by URCS. The defendant railroad proposing the adjustment would have the burden of showing that the cost in question is incurred on the movement at issue and that the cost is not accurately captured by URCS. The intent is to recognize costs for which a railroad would not be compensated given the conventions of URCS. These include (1) payments to railroads and other third parties, (2) additional costs of high/wide movements, and (3) additional costs of movements of hazardous materials.²²

AAR emphasizes that its proposed modification is limited and would apply only in unusual cases, with the burden of proof to be borne by the defendant railroad. For the vast majority of cases where URCS in fact gives an approximation of actual costs incurred, AAR supports the Board's effort to simplify proceedings by eliminating disputes over variable costs.

The Board should also note that AAR's proposed modification of the flat prohibition on any departures from system average URCS is very different from positions that have been advanced by shipper interests. In the past at least, shippers have argued in favor of retaining the right to do special variable cost studies across the full range of rail movements. Shippers have

²¹ *Major Issues in Rail Rate Cases*, slip op. at 50-61 (served Oct. 30, 2006).

²² See Opening Comments of BNSF Railway Company, at 11-12; Comments of Canadian National Railway Company, at 4-5; Comments of Canadian Pacific Railway Company, at 12-15; Opening Comments of Norfolk Southern Railway Company and CSX Transportation, Inc., at 15-22; Opening Submission of Union Pacific Railroad Company at 34-36, 41-42.

advocated that the results of these special studies in areas such as road property investment and maintenance of ways costs should routinely be substituted for readily available system average URCS variable cost components. This desire to depart from URCS on a routine basis is a far cry from the railroads' proposal, which is simply to be given the right to identify costs that are actually incurred but that are not captured or are grossly understated by URCS. The burden of this proposal in simplified rate cases should be minimal. Actual cost data should be readily ascertainable and any disputes could be worked out through the consultations and technical conferences that are already included as part of the Board's proposals for simplified procedures.

VII. The Board Should Not Apply Watered-Down Standards to Petitions to Revoke Exemptions

AAR's opening comments suggested that, to revoke an exemption to permit a rate case on heretofore exempt traffic, the Board must engage in the same type of searching inquiry that led to the original grant of exemption. AAR notes that in its opening comments the U.S. Department of Transportation ("USDOT") advanced a similar view. According to USDOT, the Board should require "those seeking to revoke exemptions to bear the usual burden of proof in meeting the statutory standard."²³ USDOT "would oppose any suggestion that these exemptions may be dispensed with on some other basis simply because they arise in the context of rate regulation."²⁴ USDOT's views on the revocation issue reflect sound policy and should be followed by the Board.

VIII. Conclusion

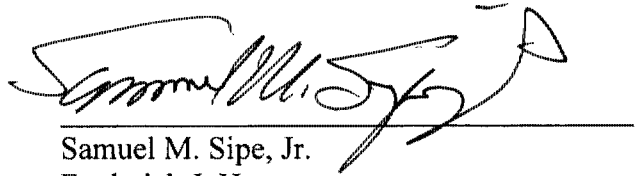
The Board has taken a positive step with its proposed general framework of eligibility criteria and simplified rate standards. The shippers' criticisms of the Board's proposals are

²³ Initial Comments of the United States Department of Transportation, at 3.

²⁴ *Id.*

consistently wide of the mark, and, in any event, the shippers have proposed no constructive alternatives. The Board should modify its proposed rules in accordance with the suggestions set forth in AAR's opening and reply comments.

Respectfully submitted



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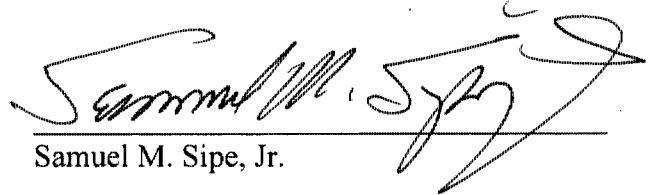
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CERTIFICATE OF SERVICE

I, Samuel M. Sipe, Jr., hereby certify that on this 30th day of November, 2006, I caused a copy of the Reply Comments of the Association of American Railroads to be served by first-class mail or a more expeditious method of delivery upon all persons identified on the Board's service list for STB Ex Parte No. 646 (Sub-No. 1).



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